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Euro Monitor 2012 : is the Eurozone turning the corner ?

Lunchtalk, 27 November 2012

Speaker: **Michael Heise**, Chief Economist, Allianz SE

Discussants: **Anne Bucher**, Director at DG Ecfin, European Commission and **André Sapir**, Senior Fellow at Bruegel and Professor of Economics at ULB

Chair: **Zsolt Darvas**, Research Fellow at Bruegel

Michael Heise presented the Allianz Euro Monitor, which is a system of indicators that measure macroeconomic imbalances within the euro area. They can be compared with the European Commission scoreboard in its Macroeconomic Imbalance Procedure (MIP).[1]

Euro Monitor's 14 indicators are grouped into four categories: (i) fiscal sustainability; (ii) competitiveness and domestic demand; (iii) jobs, productivity and resource efficiency; (iv) private and foreign debt. In addition to looking at individual indicators, the Euro Monitor also provides aggregate indices for the above four categories as well as a single aggregate index.

The top three euro area countries, i.e. those with smallest imbalances, were Germany, Austria and Luxembourg. The bottom three were Ireland, Greece and Cyprus. Interestingly, by the aggregate metric Italy was judged to have larger imbalances than Spain.

Heise argued that even Germany's score, 7.7/10, was not particularly high. Some of its weaknesses were low labour productivity and high government debt. Therefore all euro area economies need to adjust.

Although the level of fundamentals was weak, Heised stressed that all GIPS countries bar Ireland had improved their aggregate indicator since 2011. Ireland's problem was its continued high budget deficit. Debt to GDP levels were still rising in GIPS countries and in France and Italy. Germany was an exception as it had managed to stabilize its debt ratio. Nevertheless, the underlying deficits had been reduced, which Heise maintained was an impressive achievement in a challenging macroeconomic climate.
An interesting fact was that interest payments as a share of total government expenditures had declined in Greece and its overall interest rate was now only 3 %.

Heise pointed out that competitiveness is being regained in the GIPS countries because their unit labour costs have decreased dramatically lately. This had not happened in Italy though.

The current account balances of GIPS countries had improved but interestingly this had not happened at the expense of reducing Germany's surplus, which has staid remarkably steady at around 4 %. It seems that German export industries have found new markets quite rapidly.

Heise argued that it is valuable to assess simultaneously competitiveness and domestic demand because the latter should not in principle be repressed by pursuing only the former. Nevertheless, Heise claimed that the recent decline in domestic demand in GIPS countries was inevitable given its

[1] Indeed, the Euro Monitor includes seven of the same indicators as the European Commission scoreboard.

unsustainable earlier rise. It was also striking how little German domestic demand had risen during the 2000s although it had experienced a marked pick-up in the last couple of years.

In Ireland private debt had declined a lot but it was still the highest among the GIPS and the big-three (GER, FRA, ITA) countries. Ireland's problem was especially the high debt of non-financial corporations. To conclude, Heise noted that even though the cyclical situation is bad, there have been improvements in many imbalance indicators. The interesting question was whether markets would believe this and give credit to the GIPS countries for the structural reforms they have made.

Q & A session

The transparency of the Euro Monitor was praised although questions were raised regarding its methodology and applicability for policy conclusions. The difference between surveillance and simple scoring & ranking was underscored. Indices were not thought to be enough to constitute an independent assessment of potential vulnerabilities but could serve as a trigger for a more detailed inquiry. It was also argued that the euro area as a whole is sound and even the weakest countries have made great progress, for instance in improving their structural budget deficits and current-accounts.

There existed some unease about mixing variables that can be directly affected by policy with those that can be influenced only indirectly because this is not helpful in providing policy recommendations. It was also argued that it is not enough to look at countries individually because of significant externalities within the euro area, for instance in fiscal consolidation and financial markets. A more coordinated approach to adjustment is needed. The forecasting ability of the Euro Monitor was also questioned, as Ireland was level with Germany before the crisis.

Heise agreed with some of the criticism, but defended the role of the Euro Monitor in drawing interest in issues that would otherwise receive too little attention. He agreed that a better indicator of vulnerabilities in the financial system should be included (the lack of which explains Ireland's good score pre-crisis).

Other topics discussed concerned whether: (i) the positive trends will continue; (ii) social tensions will escalate; (iii) the increase in competitiveness and improvement in external balances in GIPS countries is the result of fundamental improvement or of collapsing economic activity. There was shared hope on the first two questions, while the last one generated more differentiated viewpoints. Nevertheless, the growth of GIPS exports was acknowledged as well as the fact that the structural adjustments already made will bear fruit in the future.

Event notes by Erkki Vihriälä